

PRINCIPLES OF Corporate Governance

2016



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Foreword and Introduction

Business Roundtable has been recognized for decades as an authoritative voice on matters affecting American business corporations and meaningful and effective corporate governance practices.

Since Business Roundtable last updated *Principles of Corporate Governance* in 2012, U.S. public companies have continued to adapt and refine their governance practices within the framework of evolving laws and stock exchange rules. Business Roundtable CEOs continue to believe that the United States has the best corporate governance, financial reporting and securities markets systems in the world. These systems work because they give public companies not only a framework of laws and regulations that establish minimum requirements but also the flexibility to implement customized practices that suit the companies' needs and to modify those practices in light of changing conditions and standards.

Over the last several years, the external environment in which public companies operate has become increasingly complex for companies and shareholders alike. The increased regulatory burdens imposed on public companies in recent years have added to the costs and complexity of overseeing and managing a corporation's business and bring new challenges from operational, regulatory and compliance perspectives. In addition, many U.S. public companies have a global profile; they interact with investors, suppliers, customers and government regulators around the world and do so in an era in which instant communication is the norm. Further, in the recent past, Congress has abandoned strict adherence to the fundamental principle of *materiality*, a central tenet of the disclosure requirements of the federal securities laws. Instead, Congress has sought to use the securities laws to address issues that are immaterial to shareholders' investment or voting decisions. For example, Congress has required public companies to disclose information relating to conflict minerals and payments to foreign governments for resource extraction and mine safety, information that may be relevant in a social context but has little relevance to material information that a shareholder would need to make an investment decision.

The current environment has also been shaped by fundamental changes in shareholder engagement, which has become a central and essential topic for public companies and their boards, managers and investors in the early 21st century. Public companies have undertaken unprecedented levels of proactive engagement with their major shareholders in recent years. Many institutional investors have also increased their engagement efforts, dedicating significant resources to governance issues, company outreach, the development of voting policies and the analysis of the proposals on the ballots of their portfolio companies. In addition, overall levels of shareholder activism remain at record highs, imposing significant pressures on targeted companies and their boards.

Further, many of today's shareholders — and not only those typically viewed as "activists" — have higher expectations relating to engagement with the board and management than shareholders of years past. These investors seek a greater voice in the company's strategic decisionmaking, capital allocation and overall corporate social responsibility, areas that traditionally were the sole purview of the board and management. Moreover, some shareholder-driven campaigns to change corporate

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strategies (through spin-offs, for example) or capital allocation strategies (through share repurchase programs) suggest that in some cases, at least, shareholder input on these matters has been heard in the boardroom. Some commentators view this rise in shareholder empowerment as appropriate, arguing that shareholders are the ultimate owners of the company. Others question, however, whether activists' goals are overly focused on short-term uses of corporate capital, such as share repurchases or special dividends. Capital allocation strategies focusing on short-term value may be entirely appropriate for a shareholder, regardless of the length of its investment horizon. The board, however, has a very different role when considering the appropriate use of capital for the company and all of its shareholders. Specifically, the board must constantly weigh both long-term and short-term uses of capital (for example, organic or inorganic reinvestment, returns to shareholders, etc.) and then determine the appropriate allocation of that capital in keeping with the company's business strategy and the goal of long-term value creation.

Business Roundtable CEOs believe that shareholder engagement will continue to be a critical corporate governance issue for U.S. companies in the years to come. Further, it is our sense that there is a growing recognition in corporate America that an increase in shareholder access to the boardroom cannot come without a corresponding increase in shareholder responsibility. Here, as in many areas of corporate governance, transparency is a basic but essential element — for example, in this “age of information,” a shareholder that wishes to influence corporate behavior should be encouraged to publicly disclose the nature of its identity and ownership, even in cases where the federal securities laws may not specifically require disclosure.

We sense that there is a rising belief that shareholders cannot seek additional empowerment without assuming some accountability for the goal of long-term value creation for all shareholders.

More fundamentally, we believe that the responsibility of shareholders extends beyond disclosure. We sense that there is a rising belief that shareholders cannot seek additional empowerment without assuming some accountability for the goal of long-term value creation for all shareholders. Moreover, we believe that shareholders should not use their investments in U.S. public companies for purposes that are not in keeping with the purposes of for-profit public enterprises, including

but not limited to the advancement of personal or social agendas unrelated and/or immaterial to the company's business strategy.

We believe that this concept of shareholder responsibility and accountability will — and should — become an integral part of modern thinking relating to corporate governance in the coming years, and we look forward to taking a leadership role in discussions relating to these important issues.

In light of the evolving landscape affecting U.S. public companies, Business Roundtable has updated *Principles of Corporate Governance*. Although Business Roundtable believes that these principles represent current practical and effective corporate governance practices, it recognizes that wide variations exist among the businesses, relevant regulatory regimes, ownership structures and investors of U.S. public companies. **No one approach to corporate governance may be right for all companies, and Business Roundtable does not prescribe or endorse any particular option, leaving that to the considered judgment of boards, management and shareholders. Accordingly, each company should look to these principles as a guide in developing the structures, practices and processes that are appropriate in light of its needs and circumstances.**

Guiding Principles of Corporate Governance

Business Roundtable supports the following core guiding principles:

1. The board approves corporate strategies that are intended to build sustainable long-term value; selects a chief executive officer (CEO); oversees the CEO and senior management in operating the company's business, including allocating capital for long-term growth and assessing and managing risks; and sets the "tone at the top" for ethical conduct.
2. Management develops and implements corporate strategy and operates the company's business under the board's oversight, with the goal of producing sustainable long-term value creation.
3. Management, under the oversight of the board and its audit committee, produces financial statements that fairly present the company's financial condition and results of operations and makes the timely disclosures investors need to assess the financial and business soundness and risks of the company.
4. The audit committee of the board retains and manages the relationship with the outside auditor, oversees the company's annual financial statement audit and internal controls over financial reporting, and oversees the company's risk management and compliance programs.
5. The nominating/corporate governance committee of the board plays a leadership role in shaping the corporate governance of the company, strives to build an engaged and diverse board whose composition is appropriate in light of the company's needs and strategy, and actively conducts succession planning for the board.
6. The compensation committee of the board develops an executive compensation philosophy, adopts and oversees the implementation of compensation policies that fit within its philosophy, designs compensation packages for the CEO and senior management to incentivize the creation of long-term value, and develops meaningful goals for performance-based compensation that support the company's long-term value creation strategy.
7. The board and management should engage with long-term shareholders on issues and concerns that are of widespread interest to them and that affect the company's long-term value creation. Shareholders that engage with the board and management in a manner that may affect corporate decisionmaking or strategies are encouraged to disclose appropriate identifying information and to assume some accountability for the long-term interests of the company and its shareholders as a whole. As part of this responsibility, shareholders should recognize that the board must continually weigh both short-term and long-term uses of capital when determining how to allocate it in a way that is most beneficial to shareholders and to building long-term value.

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8. In making decisions, the board may consider the interests of all of the company's constituencies, including stakeholders such as employees, customers, suppliers and the community in which the company does business, when doing so contributes in a direct and meaningful way to building long-term value creation.

Principles of Corporate Governance is intended to assist public company boards and management in their efforts to implement appropriate and effective corporate governance practices and serve as spokespersons for the public dialogue on evolving governance standards. Although there is no "one size fits all" approach to governance that will be suitable for all U.S. public companies, the creation of long-term value is the ultimate measurement of successful corporate governance, and it is important that shareholders and other stakeholders understand why a company has chosen to use particular governance structures, practices and processes to achieve that objective. Accordingly, companies should disclose not only the types of practices they employ but also their bases for selecting those practices.



I. Key Corporate Actors

Effective corporate governance requires a clear understanding of the respective roles of the board, management and shareholders; their relationships with each other; and their relationships with other corporate stakeholders. Before discussing the core guiding principles of corporate governance, Business Roundtable believes describing the roles of these key corporate actors is important.

- ❶ The **board of directors** has the vital role of overseeing the company's management and business strategies to achieve long-term value creation. Selecting a well-qualified chief executive officer (CEO) to lead the company, monitoring and evaluating the CEO's performance, and overseeing the CEO succession planning process are some of the most important functions of the board. The board delegates to the CEO — and through the CEO to other senior management — the authority and responsibility for operating the company's business. Effective directors are diligent monitors, but not managers, of business operations. They exercise vigorous and diligent oversight of a company's affairs, including key areas such as strategy and risk, but they do not manage — or micromanage — the company's business by performing or duplicating the tasks of the CEO and senior management team. The distinction between oversight and management is not always precise, and some situations (such as a crisis) may require greater board involvement in operational matters. In addition, in some areas (such as the relationship with the outside auditor and executive compensation), the board has a direct role instead of an oversight role.

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- ❶ **Management**, led by the CEO, is responsible for setting, managing and executing the strategies of the company, including but not limited to running the operations of the company under the oversight of the board and keeping the board informed of the status of the company's operations. Management's responsibilities include strategic planning, risk management and financial

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reporting. An effective management team runs the company with a focus on executing the company's strategy over a meaningful time horizon and avoids an undue emphasis on short-term metrics.

- **Shareholders** invest in a corporation by buying its stock and receive economic benefits in return. Shareholders are not involved in the day-to-day management of business operations, but they have the right to elect representatives (directors) and to receive information material to investment and voting decisions. Shareholders should expect corporate boards and managers to act as long-term stewards of their investment in the corporation. They also should expect that

the board and management will be responsive to issues and concerns that are of widespread interest to long-term shareholders and affect the company's long-term value. Corporations are for-profit enterprises that are designed to provide sustainable long-term value to all shareholders. Accordingly, shareholders should not expect to use the public companies in which they invest as platforms for the advancement of their personal agendas or for the promotion of general political or social causes.

Some shareholders may seek a voice in the company's strategic direction and decisionmaking — areas that traditionally were squarely within the realm of the board and management. Shareholders who seek this influence should recognize that this type of empowerment necessarily involves the assumption of a degree of responsibility for the goal of long-term value creation for the company and all of its shareholders.

Effective corporate governance requires dedicated focus on the part of directors, the CEO and senior management to their own responsibilities and, together with the corporation's shareholders, to the shared goal of building long-term value.



II. Key Responsibilities of the Board of Directors and Management

An effective system of corporate governance provides the framework within which the board and management address their key responsibilities.

Board of Directors

A corporation's business is managed under the board's oversight. The board also has direct responsibility for certain key matters, including the relationship with the outside auditor and executive compensation. The board's oversight function encompasses a number of responsibilities, including:

- ❶ **Selecting the CEO.** The board selects and oversees the performance of the company's CEO and oversees the CEO succession planning process.
- ❷ **Setting the "tone at the top."** The board should set a "tone at the top" that demonstrates the company's commitment to integrity and legal compliance. This tone lays the groundwork for a corporate culture that is communicated to personnel at all levels of the organization.
- ❸ **Approving corporate strategy and monitoring the implementation of strategic plans.** The board should have meaningful input into the company's long-term strategy from development through execution, should approve the company's strategic plans and should regularly evaluate implementation of the plans that are designed to create long-term value. The board should understand the risks inherent in the company's strategic plans and how those risks are being managed.
- ❹ **Setting the company's risk appetite, reviewing and understanding the major risks, and overseeing the risk management processes.** The board oversees the process for identifying and managing the significant risks facing the company. The board and senior management should agree on the company's risk appetite, and the board should be comfortable that the strategic

plans are consistent with it. The board should establish a structure for overseeing risk, delegating responsibility to committees and overseeing the designation of senior management responsible for risk management.

- ❶ **Focusing on the integrity and clarity of the company's financial reporting and other disclosures about corporate performance.** The board should be satisfied that the company's financial statements accurately present its financial condition and results of operations, that other disclosures about the company's performance convey meaningful information about past results as well as future plans, and that the company's internal controls and procedures have been designed to detect and deter fraudulent activity.

The board should have meaningful input and decisionmaking authority over the company's capital allocation process and strategy to find the right balance between short-term and long-term economic returns for its shareholders.

- ❶ **Allocating capital.** The board should have meaningful input and decisionmaking authority over the company's capital allocation process and strategy to find the right balance between short-term and long-term economic returns for its shareholders.
- ❶ **Reviewing, understanding and overseeing annual operating plans and budgets.** The board oversees the annual operating plans and reviews annual budgets presented by management. The board monitors implementation of the annual plans and assesses whether they are responsive to changing conditions.
- ❶ **Reviewing the company's plans for business resiliency.** As part of its risk oversight function, the board periodically reviews management's plans to address business resiliency, including such items as business continuity, physical security, cybersecurity and crisis management.
- ❶ **Nominating directors and committee members, and overseeing effective corporate governance.** The board, under the leadership of its nominating/corporate governance committee, nominates directors and committee members and oversees the structure, composition (including independence and diversity), succession planning, practices and evaluation of the board and its committees.
- ❶ **Overseeing the compliance program.** The board, under the leadership of appropriate committees, oversees the company's compliance program and remains informed about any significant compliance issues that may arise.

CEO and Management

The CEO and management, under the CEO's direction, are responsible for the development of the company's long-term strategic plans and the effective execution of the company's business in accordance with those strategic plans. As part of this responsibility, management is charged with the following duties.

- ❶ **Business operations.** The CEO and management run the company's business under the board's oversight, with a view toward building long-term value.
- ❷ **Strategic planning.** The CEO and senior management generally take the lead in articulating a vision for the company's future and in developing strategic plans designed to create long-term value for the company, with meaningful input from the board. Management implements the plans following board approval, regularly reviews progress against strategic plans with the board, and recommends and carries out changes to the plans as necessary.
- ❸ **Capital allocation.** The CEO and senior management are responsible for providing recommendations to the board related to capital allocation of the company's resources, including but not limited to organic growth; mergers and acquisitions; divestitures; spin-offs; maintaining and growing its physical and nonphysical resources; and the appropriate return of capital to shareholders in the form of dividends, share repurchases and other capital distribution means.
- ❹ **Identifying, evaluating and managing risks.** Management identifies, evaluates and manages the risks that the company undertakes in implementing its strategic plans and conducting its business. Management also evaluates whether these risks, and related risk management efforts, are consistent with the company's risk appetite. Senior management keeps the board and relevant committees informed about the company's significant risks and its risk management processes.
- ❺ **Accurate and transparent financial reporting and disclosures.** Management is responsible for the integrity of the company's financial reporting system and the accurate and timely preparation of the company's financial statements and related disclosures. It is management's responsibility — under the direction of the CEO and the company's principal financial officer — to establish, maintain and periodically evaluate the company's internal controls over financial reporting and the company's disclosure controls and procedures, including the ability of such controls and procedures to detect and deter fraudulent activity.
- ❻ **Annual operating plans and budgets.** Senior management develops annual operating plans and budgets for the company and presents them to the board. The management team implements and monitors the operating plans and budgets, making adjustments in light of changing conditions, assumptions and expectations, and keeps the board apprised of significant developments and changes.

The CEO and management run the company's business under the board's oversight, with a view toward building long-term value.

- ❶ **Selecting qualified management, establishing an effective organizational structure and ensuring effective succession planning.** Senior management selects qualified management, implements an organizational structure, and develops and executes thoughtful career development and succession planning strategies that are appropriate for the company.
- ❶ **Business resiliency.** Management develops, implements and periodically reviews plans for business resiliency that provide the most critical protection in light of the company's operations.

Management identifies the company's major business and operational risks, including those relating to natural disasters, leadership gaps, physical security, cybersecurity, regulatory changes and other matters.

- **Risk identification.** Management identifies the company's major business and operational risks, including those relating to natural disasters, leadership gaps, physical security, cybersecurity, regulatory changes and other matters.
- **Crisis preparedness.** Management develops and implements crisis preparedness and response plans and works with the board to identify situations (such as a crisis involving senior management) in which the board may need to assume a more active response role.



III. Board Structure

Public companies employ diverse approaches to board structure and operations within the parameters of applicable legal requirements and stock market rules. Although no one structure is right for every company, Business Roundtable believes that the practices set forth in the following sections provide an effective approach for companies to follow.

Board Composition

- ❶ **Size.** In determining appropriate board size, directors should consider the nature, size and complexity of the company as well as its stage of development. Larger boards often bring the benefit of a broader mix of skills, backgrounds and experience, while smaller boards may be more cohesive and may be able to address issues and challenges more quickly.
- ❶ **Composition.** The composition of a board should reflect a diversity of thought, backgrounds, skills, experiences and expertise and a range of tenures that are appropriate given the company's current and anticipated circumstances and that, collectively, enable the board to perform its oversight function effectively.
 - **Diversity.** Diverse backgrounds and experiences on corporate boards, including those of directors who represent the broad range of society, strengthen board performance and promote the creation of long-term shareholder value. Boards should develop a framework for identifying appropriately diverse candidates that allows the nominating/corporate governance committee to consider women, minorities and others with diverse backgrounds as candidates for each open board seat.

Diverse backgrounds and experiences on corporate boards, including those of directors who represent the broad range of society, strengthen board performance and promote the creation of long-term shareholder value.

- **Tenure.** Directors with a range of tenures can contribute to the effectiveness of a board. Recent additions to the board may provide new perspectives, while directors who have served for a number of years bring experience, continuity, institutional knowledge, and insight into the company's business and industry.
- ❶ **Characteristics.** Every director should have integrity, strong character, sound judgment, an objective mind and the ability to represent the interests of all shareholders rather than the interests of particular constituencies.
- ❶ **Experience.** Directors with relevant business and leadership experience can provide the board a useful perspective on business strategy and significant risks and an understanding of the challenges facing the business.
- ❶ **Independence.** Director independence is critical to effective corporate governance, and providing objective independent judgment that represents the interests of all shareholders is at the core of the board's oversight function. Accordingly, a substantial majority of the board's directors should be independent, according to applicable rules and regulations and as determined by the board.
 - **Definition of "independence."** An independent director should not have any relationships that may impair, or appear to impair, the director's ability to exercise independent judgment. Many boards have developed their own standards for assessing independence under stock market definitions, in addition to considering the views of institutional investors and other relevant groups.
 - **Assessing independence.** When evaluating a director's independence, the board should consider all relevant facts and circumstances, focusing on whether the director has any relationships, either direct or indirect, with the company, senior management or other directors that could affect actual or perceived independence. This includes relationships with other companies that have significant business relationships with the company or with not-for-profit organizations that receive substantial support from the company. While it has been suggested that long-standing board service may be perceived to affect director independence, long tenure, by itself, should not disqualify a director from being considered independent.
- ❶ **Election.** Directors should be elected by a majority vote for terms that are consistent with long-term value creation. Boards should adopt a resignation policy under which a director who does not receive a majority vote tenders his or her resignation to the board for its consideration. Although the ultimate decision whether to accept or reject the resignation will rest with the board, the board and its nominating/corporate governance committee should think critically about the reasons why the director did not receive a majority vote and whether or not the director should continue to serve. Among other things, they should consider whether the vote resulted from concerns about a policy issue affecting the board as a whole or concerns specific to the individual director and the basis for those concerns.
- ❶ **Time commitments.** Serving as a director of a public company requires significant time and attention. Certain roles, such as committee chair, board chair and lead director, carry an additional time commitment beyond that of board and committee service. Directors must

spend the time needed and meet as frequently as necessary to discharge their responsibilities properly. While there may not be a need for a set limit on the number of outside boards on which a director or committee member may serve — or for any limits on other activities a director may pursue outside of his or her board duties — each director should be committed to the responsibilities of board service, and each board should monitor the time constraints of its members in light of their particular circumstances.

Board Leadership

- ❶ **Approaches.** U.S. companies take a variety of approaches to board leadership; some combine the positions of CEO and chair while others appoint a separate chair. No one leadership structure is right for every company at all times, and different boards may reach different conclusions about the leadership structures that are most appropriate at any particular point in time. When appropriate in light of its current and anticipated circumstances, a board should assess which leadership structure is appropriate.

No one leadership structure is right for every company at all times, and different boards may reach different conclusions about the leadership structures that are most appropriate at any particular point in time.

- ❶ **Lead/presiding director.** Independent board leadership is critical to effective corporate governance regardless of the board's leadership structure. Accordingly, the board should appoint a lead director, also referred to as a presiding director, if it combines the positions of CEO and chair or has a chair who is not independent. The lead director should be appointed by the independent directors and should serve for a term determined by the independent directors.

Lead directors perform a range of functions depending on the board's needs, but they typically chair executive sessions of a board's independent or nonmanagement directors, have the authority to call executive sessions, and oversee follow-up on matters discussed in executive sessions. Other key functions of the lead director include chairing board meetings in the absence of the board chair, reviewing and/or approving agendas and schedules for board meetings and information sent to the board, and being available for engagement with long-term shareholders.

Board Committee Structure

- ❶ An effective committee structure permits the board to address key areas in more depth than may be possible at the full board level. Decisions about committee membership and chairs should be made by the full board based on recommendations from the nominating/corporate governance committee.
- ❶ The functions performed by the audit, nominating/corporate governance and compensation committees are central to effective corporate governance; however, no one committee structure or division of responsibility is right for all companies. Thus, the references in Section IV to functions performed by particular committees are not intended to preclude companies from allocating these functions differently.

- ❶ The responsibilities of each committee and the qualifications required for committee membership should be clearly defined in a written charter that is approved by the board. Each committee should review its charter annually and recommend changes to the board. Committees should apprise the full board of their activities on a regular basis.
- ❶ Board committees should meet all applicable independence and other requirements as to membership (including minimum number of members) prescribed by applicable law and stock exchange rules.



IV. Board Committees

Audit Committee

- ❶ **Financial acumen.** Audit committee members must meet minimum financial literacy standards, and one or more committee members should be an audit committee financial expert, as determined by the board in accordance with applicable rules.
- ❷ **Overboarding.** With the significant responsibilities imposed on audit committees, consideration should be given to whether limiting service on other public company audit committees is appropriate. Policies may permit exceptions if the board determines that the simultaneous service would not affect an individual's ability to serve effectively.
- ❸ **Outside auditor.** The audit committee is responsible for the company's relationship with its outside auditor, including:
 - **Selecting and retaining the outside auditor.** The audit committee selects the outside auditor; reviews its qualifications (including industry expertise and geographic capabilities), work product, independence and reputation; and reviews the performance and expertise of key members of the audit team. The committee reviews new leading partners for the audit team and should be directly involved in the selection of the new engagement partner. The committee oversees the process of negotiating the terms of the annual audit engagement.
 - **Overseeing the independence of the outside auditor.** The committee should maintain an ongoing, open dialogue with the outside auditor about independence issues. The committee should identify those services, beyond the annual audit engagement, that it believes the outside auditor can provide to the company consistent with maintaining independence and determine whether to adopt a policy for preapproving services to be provided by the outside auditor or approving services on an engagement-by-engagement basis.

With the significant responsibilities imposed on audit committees, consideration should be given to whether limiting service on other public company audit committees is appropriate.

- ❶ **Financial statements.** The committee should discuss significant issues relating to the company's financial statements with management and the outside auditor and review earnings press releases before they are issued. The committee should understand the company's critical accounting policies and why they were chosen, what key judgments and estimates management made in preparing the financial statements, and how they affect the reported financial results. The committee should be satisfied that the financial statements and other disclosures prepared by management present the company's financial condition and results of operations accurately and are understandable.
- ❷ **Internal controls.** The committee oversees the company's system of internal controls over financial reporting and its disclosure controls and procedures, including the processes for producing the certifications required of the CEO and principal financial officer. The committee periodically reviews with both the internal and outside auditors, as well as with management, the procedures for maintaining and evaluating the effectiveness of these systems. The committee should be promptly notified of any significant deficiencies or material weaknesses in internal controls and kept informed about the steps and timetable for correcting them.
- ❸ **Risk assessment and management.** Many audit committees have at least some responsibility for risk assessment and management due to stock market rules. However, the audit committee should not be the sole body responsible for risk oversight, and the board may decide to allocate some aspects of risk oversight to other committees or to the board as a whole depending on the company's industry and other factors. A company's risk oversight structure should provide the full board with the information it needs to understand all of the company's major risks, their relationship to the company's strategy and how these risks are being addressed. Committees with risk-related responsibilities should report regularly to the full board on the risks they oversee and brief the audit committee in cases where the audit committee retains some risk oversight responsibility.
- ❹ **Compliance.** Unless the full board or one or more other committees do so, the audit committee should oversee the company's compliance program, including the company's code of conduct. The committee should establish procedures for handling compliance concerns related to potential violations of law or the company's code of conduct, including concerns relating to accounting, internal accounting controls, auditing and securities law issues.
- ❺ **Internal audit.** The committee oversees the company's internal audit function and ensures that the internal audit staff has adequate resources and support to carry out its role. The committee reviews the scope of the internal audit plan, significant findings by the internal audit staff and management's response, and the appointment and replacement of the senior internal auditing executive and assesses the performance and effectiveness of the internal audit function annually.

Nominating/Corporate Governance Committee

- ❶ **Director qualifications.** The committee should establish, and recommend to the board for approval, criteria for board membership and periodically review and recommend changes to the criteria. The committee should review annually the composition of the board, including an assessment of the mix of the directors' skills and experience; an evaluation of whether the board

as a whole has the necessary tools to effectively perform its oversight function in a productive, collegial fashion; and an identification of qualifications and attributes that may be valuable in the future based on, among other things, the current directors' skill sets, the company's strategic plans and anticipated director exits.

- **Succession planning.** The committee, together with the board, should actively conduct succession planning for the board of directors. The committee should proactively identify director candidates by canvassing a variety of sources for potential candidates and retaining search firms. Shareholders invested in the long-term success of the company should have a meaningful opportunity to nominate directors and to recommend director candidates for nomination by the committee, which may include proxy access if shareholder support is broad based and the board concludes this access is in the best interests of the company and its shareholders. Although the CEO meeting with potential board candidates is appropriate, the final responsibility for selecting director nominees should rest with the nominating/corporate governance committee and the board.

The committee should review annually the composition of the board, including an assessment of the mix of the directors' skills and experience; an evaluation of whether the board as a whole has the necessary tools to effectively perform its oversight function in a productive, collegial fashion; and an identification of qualifications and attributes that may be valuable in the future.

- **Background and experience.** In connection with renomination of a current director, the nominating/corporate governance committee should review the director's background, perspective, skills and experience; assess the director's contributions to the board; consider the director's tenure; and evaluate the director's continued value to the company in light of current and future needs. Some boards may undertake these steps as part of the annual nomination process, while others may use a director evaluation process.
- **Independence.** The nominating/corporate governance committee should ensure that a substantial majority of the directors are independent both in fact and in appearance. The committee should take the lead in assessing director independence and make recommendations to the board regarding independence determinations. In addition, each director should promptly notify the committee of any change in circumstances that may affect the director's independence (including but not limited to employment change or other factors that could affect director independence).
- **Tenure limits.** The committee should consider whether procedures such as mandatory retirement ages or term limits are appropriate. Other practices, such as a robust director evaluation process, may make these tenure limits unnecessary, but they may still serve as useful tools for ensuring board engagement and maintaining diversity and freshness of thought. Many boards also require that directors who change their primary employment tender their resignation so that the board may consider the desirability of their continued service in light of their changed circumstances.

- ❶ **Board leadership.** The committee should conduct an annual evaluation of the board's leadership structure and recommend any changes to the board. The committee should oversee the succession planning process for the board chair, which should involve consideration of whether to combine or separate the positions of CEO and board chair and whether events such as the end of the current chair's tenure or the appointment of a new CEO may warrant a change to the board leadership structure.
- ❷ **Committee structure.** Annually, the committee should recommend directors for appointment to board committees and ensure that the committees consist of directors who meet applicable independence and qualification standards. The committee should periodically review the board's committee structure and consider whether refreshment of committee memberships and chairs would be helpful.
- ❸ **Board oversight.** The committee should oversee the effective functioning of the board, including the board's policies relating to meeting agendas and schedules and the company's processes for providing information to the board (both in connection with, and outside of, meetings), with input from the lead director or independent chair.
- ❹ **Corporate governance guidelines.** The committee should review annually the company's corporate governance guidelines, if any, and make recommendations about changes in those guidelines to the board.
- ❺ **Shareholder engagement.** The committee may oversee the company's and management's shareholder engagement efforts, periodically review the company's engagement practices, and provide to senior management feedback and suggestions for improvement. The committee and the full board should understand the company's efforts to communicate with shareholders and receive regular briefings on such communications.
- ❻ **Director compensation.** The committee also may oversee the compensation of the board if the compensation committee does not do so, or the two committees may share this responsibility.

Compensation Committee

- ❶ **Authority.** The compensation committee has many responsibilities relating to the company's overall compensation philosophy, structure, policies and programs. To assist it in performing its duties, the compensation committee must have the authority to obtain advice from independent compensation consultants, counsel and other advisers. The advisers' independence should be assessed under applicable law and stock market rules, and the compensation committee should feel confident and comfortable that its advisers have the ability to provide the committee with sound advice that is free from any competing interests.
- ❷ **CEO and senior management compensation.** A major responsibility of the compensation committee is establishing performance goals and objectives relating to the CEO, measuring performance against those goals and objectives, and determining and approving the compensation of the CEO. The compensation committee also generally approves or recommends for approval the compensation of the rest of the senior management team.

❶ **Alignment with shareholder interests.** Executive compensation should be designed to align the interests of senior management, the company and its shareholders and to foster the long-term value creation and success of the company. Compensation should include performance-based elements that reward the achievement of goals tied to the company's strategic plan but are at risk if such goals are not met. These performance goals should be clearly explained to the company's shareholders.

Executive compensation should be designed to align the interests of senior management, the company and its shareholders and to foster the long-term value creation and success of the company.

❷ **Compensation costs and benefits.** The compensation committee should understand the costs of the compensation packages of senior management and should review and understand the maximum amounts that could become payable under multiple scenarios (such as retirement; termination for cause; termination without cause; resignation for good reason; death and disability; and the impact of a transaction, such as a merger, divestiture or acquisition). The committee should ensure that the proper protections are in place that will allow senior management to remain focused on the long-term strategies and business plans of the company even in the face of a potential acquisition, shareholder activism, or unsolicited takeover activity or control bids.

❸ **Stock ownership requirements.** To further align the interests of directors and senior management with the interests of long-term shareholders, the committee should establish stock ownership and holding requirements that require directors and senior management to acquire and hold a meaningful amount of the company's stock at least for the duration of their tenure and, depending on the company's circumstances, perhaps for a certain period of time thereafter. The company should have a policy that monitors, restricts or even prohibits executive officers' ability to hedge the company's stock and requires ongoing disclosure of the material terms of hedging arrangements to the extent they are permitted.

❹ **Risk.** The compensation committee should review the overall compensation structure and balance the need to create incentives that encourage growth and strong financial performance with the need to discourage excessive risk-taking, both for senior management and for employees at all levels. Incentives should further the company's long-term strategic plans by looking beyond short-term market value changes to the overall goal of creating and enhancing enduring value. The committee should oversee the adoption of practices and policies to mitigate risks created by compensation programs, such as a compensation recoupment, or clawback, policy.

❺ **Director compensation.** The compensation committee may also be responsible, either alone or together with the nominating/corporate governance committee, for establishing director compensation programs, practices and policies.



V. Board Operations

- ❶ **General.** Serving on a board requires significant time and attention on the part of directors. Certain roles, such as committee chair, board chair and lead director, carry an additional time commitment beyond that of board and committee service. Directors must spend the time needed and meet as frequently as necessary to discharge their responsibilities properly.
- ❷ **Meetings.** The board of directors, with the assistance of the nominating/corporate governance committee, should consider the frequency and length of board meetings. Longer meetings may permit directors to explore key issues in depth, whereas shorter, more frequent meetings may help directors stay current on emerging corporate trends and business and regulatory developments.
- ❸ **Overboarding.** Service on the board of a public company provides valuable experience and insight. Simultaneous service on too many boards may, however, interfere with an individual's ability to satisfy his or her responsibilities as a member of senior management or as a director. In light of this, many boards limit the number of public company boards on which their directors may serve. Business Roundtable does not endorse a specific limit on the number of directorships an individual may hold, recognizing that decisions about limits on board service are best made by boards and their nominating/governance committees in light of the particular circumstances of individual companies and directors.
- ❹ **Executive sessions.** Directors should have sufficient opportunity to meet in executive session, outside the presence of the CEO and any other management directors, in accordance with stock exchange rules. Time for an executive session should be placed on the agenda for every regular board meeting. The independent chair or lead director should set the agenda for and chair these sessions and follow up with the CEO and other members of senior management on matters addressed in the sessions.

- ❶ **Agenda.** The board's agenda must be carefully planned yet flexible enough to accommodate emergencies and unexpected developments, and it must be structured to maximize the use of meeting time for open discussion and deliberation. The board chair should work with the lead director (when the company has one) in setting the agenda and should be responsive to individual directors' requests to add items to the agenda.
- ❷ **Access to management.** The board should work to foster open, ongoing dialogue between management and members of the board. Directors should have access to senior management outside of board meetings.
- ❸ **Information.** The quality and timeliness of information that the board receives directly affects its ability to perform its oversight function effectively.
- ❹ **Technology.** Companies should take advantage of technology such as board portals to provide directors with meeting materials and real-time information about developments that occur between meetings. The use of technology (including e-mail) to communicate with and deliver information to the board should be accompanied by safeguards to protect the security of information and directors' electronic devices and to comply with applicable document retention policies.
- ❺ **Confidentiality.** Directors have a duty to maintain the confidentiality of all nonpublic information (whether or not it is material) that they learn through their board service, including boardroom discussions and other discussions between and among directors and senior management.
- ❻ **Director compensation.** The amount and composition of the compensation paid to a company's nonemployee directors should be carefully considered by the board with the oversight of the appropriate board committee. Director compensation typically consists of a mix of cash and equity. The cash portion of director compensation should be paid in the form of an annual retainer, rather than through meeting fees, to reflect the fact that board service is an ongoing commitment. Equity compensation helps align the interests of directors with those of the corporation's shareholders but should be provided only through shareholder-approved plans that include meaningful and effective limitations. Further, equity compensation arrangements should be carefully designed to avoid unintended incentives such as an emphasis on short-term market value changes. Due to the potential for conflicts of interest and the duty of directors to represent the interests of all shareholders, directors or director nominees should not be a party to any compensation-related arrangements with any third party relating to their candidacy or service as a director of the company, other than those arrangements that relate to reimbursement for expenses in connection with candidacy as a director.

Due to the potential for conflicts of interest and the duty of directors to represent the interests of all shareholders, directors or director nominees should not be a party to any compensation-related arrangements with any third party relating to their candidacy or service as a director of the company, other than those arrangements that relate to reimbursement for expenses in connection with candidacy as a director.

- ❶ **Director education.** Directors should be encouraged to take advantage of educational opportunities in the form of outside programs or “in board” educational sessions led by members of senior management or outside experts. New directors should participate in a robust orientation process designed to familiarize them with various aspects of the company and board service.
- ❶ **Reliance.** In performing its oversight function, the board is entitled under state corporate law to rely on the advice, reports and opinions of management, counsel, auditors and expert advisers. Boards should be comfortable with the qualifications of those on whom they rely. Boards are encouraged to engage outside advisers where appropriate and should use care in their selection. Directors should hold advisers accountable and ask questions and obtain answers about the processes they use to reach their decisions and recommendations, as well as about the substance of the advice and reports they provide to the board.
- ❶ **Board and committee evaluations.** The board should have an effective mechanism for evaluating its performance on a continuing basis. Meaningful board evaluation requires an assessment of the effectiveness of the full board, the operations of board committees and the contributions of individual directors on an annual basis. The results of these evaluations should be reported to the full board, and there should be follow-up on any issues and concerns that emerge from the evaluations. The board, under the leadership of the nominating/corporate governance committee, should periodically consider what method or combination of methods will result in a meaningful assessment of the board and its committees. Common methods include written questionnaires; group discussions led by a designated director, employee or outside facilitator (often with the aid of written questions); and individual interviews.



VI. Senior Management Development and Succession Planning

- ❶ **Succession planning.** Planning for CEO and senior management development and succession in both ordinary and emergency scenarios is one of the board's most important functions. Some boards address succession planning primarily at the full board level, while others rely on a committee composed of independent directors (often the compensation committee or the nominating/corporate governance committee) to address this key area. The board, under the leadership of the responsible committee (if any), should identify the qualities and characteristics necessary for an effective CEO and monitor the development of potential internal candidates. The board or committee should engage in a dialogue with the CEO about the CEO's assessment of candidates for both the CEO and other senior management positions, and the board or committee should also discuss CEO succession planning outside the presence of the CEO. The full board should review the company's succession plan at least annually and periodically review the effectiveness of the succession planning process.
- ❶ **Management development.** The board and the independent committee (if any) with primary responsibility for oversight of succession planning also should know what the company is doing to develop talent beyond the senior management ranks. The board or committee should gain an understanding of the steps the CEO and other senior management are taking at more junior levels to develop the skills and experience important to the company's success and build a bench of future candidates for senior management roles. Directors should interact with up-and-coming members of management, both in board meetings and in less formal settings, so they have an opportunity to observe managers directly and begin developing relationships with them.

Planning for CEO and senior management development and succession in both ordinary and emergency scenarios is one of the board's most important functions.

- ❶ **CEO evaluation.** Under the oversight of an independent committee or the lead director, the board should annually review the performance of the CEO and participate with the CEO in the evaluation of members of senior management in certain circumstances. All nonmanagement members of the board should have the opportunity to participate with the CEO in senior management evaluations if appropriate. The results of the CEO's evaluation should be promptly communicated to the CEO in executive session by representatives of the independent directors and used in determining the CEO's compensation.



VII. Relationships with Shareholders and Other Stakeholders

Corporations are often said to have obligations to stakeholders other than their shareholders, including employees, customers, suppliers, the communities and environments in which they do business, and government. In some circumstances, the interests of these stakeholders are considered in the context of achieving long-term value.

Shareholders and Investors

- ❶ **Shareholder outreach.** Regular shareholder outreach and ongoing dialogue are critical to developing and maintaining effective investor relations, understanding the views of shareholders, and helping shareholders understand the plans and views of the board and management.
 - **Know who the company's shareholders are.** The nominating/corporate governance committee and the board should know who the company's major shareholders are and understand their positions on significant issues relevant to the company.
 - **Role of management.** Members of senior management are the principal spokespersons for the company and play an important role in shareholder engagement. This role includes serving as the main points of contact for shareholders on issues where management is in the best position to have a dialogue with shareholders.
 - **Board communication with shareholders.** When appropriate and in consultation with the CEO, directors should be equipped to play a part from time to time in the dialogue with shareholders on topics involving the company's pursuit of long-term value creation and the company's governance. Communications with shareholders are subject to applicable

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regulations (such as Regulation Fair Disclosure) and company policies on confidentiality and disclosure of information. These regulations and policies, however, should not impede shareholder engagement. Direct communication between directors and shareholders should be coordinated through — and with the knowledge of — the board chair, the lead independent director, and/or the nominating/corporate governance committee or its chair.

- ❶ **Annual meeting.** Directors should be expected to attend the annual meeting of shareholders, absent unusual circumstances. Companies should consider ways to broaden shareholder access to the annual meeting, including webcasts, if requested by shareholders.
- ❶ **Shareholder engagement.** Companies should engage with long-term shareholders in a manner consistent with the respective roles of the board, management and shareholders. Companies should maintain effective protocols for shareholder communications with directors and for directors to respond in a timely manner to issues and concerns that are of widespread interest to long-term shareholders.
- ❶ **Board duties.** Shareholders are not a uniform group, and their interests may be diverse. Although boards should consider the views of shareholders, the duty of the board is to act in what it believes to be the long-term best interests of the company and all its shareholders. The views of certain shareholders are one important factor that the board evaluates in making decisions, but the board must exercise its own independent judgment. Once the board reaches a decision, the company should consider how best to communicate the board's decision to shareholders.
- ❶ **Shareholder voting.** While some shareholders may use tools such as third-party analyses and recommendations in making voting decisions, these tools should not be a substitute for individualized decisionmaking that considers the facts and circumstances of each company. Companies should conduct shareholder outreach efforts where appropriate to explain the bases for the board's recommendations on the matters that are submitted to a vote of shareholders.

Shareholders should not use the shareholder proposal process as a platform to pursue social or political agendas that are largely unrelated and/or immaterial to the company's business, even if permitted by the proxy rules.

- ❶ **Shareholder proposals.** The federal proxy rules require public companies to include qualified shareholder proposals in their proxy statements. Shareholders should not use the shareholder proposal process as a platform to pursue social or political agendas that are largely unrelated and/or immaterial to the company's business, even if permitted by the proxy rules. Further, a company's proxy statement is not always the best place to address even legitimate shareholder concerns. Shareholders with concerns about particular issues should seek to engage in a dialogue with the company before submitting a shareholder proposal. If a shareholder submits a proposal, the company's board or its nominating/corporate governance committee should oversee the company's response.

The board should consider issues raised by shareholder proposals that receive substantial support from other shareholders and should communicate its response to all shareholders.

Employees

- ❶ **General.** Treating employees fairly and equitably is in a company's best interest. Companies should have in place policies and practices that provide employees with appropriate compensation, including benefits that are appropriate given the nature of the company's business and employees' job responsibilities and geographic locations. When companies offer retirement, health care, insurance and other benefit plans, employees should be fully informed of the terms of those plans.
- ❷ **Misconduct.** Companies should have in place and publicize mechanisms for employees to seek guidance and to alert management and the board about potential or actual misconduct without fear of retribution. As part of fostering a culture of compliance, companies should encourage employees to report compliance issues promptly and emphasize their policy of prohibiting retaliation against employees who report compliance issues in good faith.
- ❸ **Communications.** Companies should communicate honestly with their employees about corporate operations and financial performance.

Communities, the Environment and Sustainability

- ❶ **Citizenship.** Companies should strive to be good citizens of the local, national and international communities in which they do business; to be responsible stewards of the environment; and to consider other relevant sustainability issues in operating their businesses. Failure to meet these obligations can result in damage to the company, both in immediate economic terms and in its longer-term reputation. Because sustainability issues affect so many aspects of a company's business, from financial performance to risk management, incorporating sustainability into the business in a meaningful way is integral to a company's long-term viability.
- ❷ **Community service.** A company should strive to be a good citizen by contributing to the communities in which it operates. Being a good citizen includes getting involved with those communities; encouraging company directors, managers and employees to form relationships with those communities; donating time to causes of importance to local communities; and making charitable contributions.
- ❸ **Sustainability.** A company should conduct its business with meaningful regard for environmental, health, safety and other sustainability issues relevant to its operations. The board should be cognizant of developments relating to economic, social and environmental sustainability issues and should understand which issues are most important to the company's business and to its shareholders.

Companies should strive to be good citizens of the local, national and international communities in which they do business; to be responsible stewards of the environment; and to consider other relevant sustainability issues in operating their businesses.

Government

- ❶ **Legal compliance.** Corporations, like all citizens, must act within the law. The penalties for serious violations of law can be extremely severe, even life threatening, for corporations. Compliance is not only appropriate — it is essential. The board and management should be comfortable that the company has a robust legal compliance program that is effective in deterring and preventing misconduct and encouraging the reporting of potential compliance issues.
- ❷ **Political activities.** Corporations have an important perspective to contribute to the public policy dialogue and discussions about the development, enactment and revision of the laws and regulations that affect their businesses and the communities in which they operate and their employees reside. To the extent that the company engages in political activities, the board should have oversight responsibility and consider whether to adopt a policy on disclosure of these activities.



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